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IN THE

Supreme Court of the United States

October Term, 1931

No. 26

DAVID BURNET,
COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

HENRY HARMEL

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Motion of Walter E. Barton for Leave to File Brief as Amicus Curiae in Opposition, and Brief of Amicus Curiae in Opposition.

WALTER E. BARTON,
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IN THE

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October Term, 1931

No. 824

DAVID BURNET,
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Petitioner,

VS.

HENRY HARMEL

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Motion for Leave to File Brief as Amicus Curiae in Opposition.

May it please the Court:

The undersigned, as counsel for *W. T. Waggoner and Ella Waggoner,* respectfully moves this Honorable Court for leave to file the accompanying brief in this case as *amicus curiae* in opposition.

WALTER E. BARTON,
Investment Building,
Washington, D. C.
Counsel for W. T. Waggoner and Ella Waggoner, as Amicus Curiae.

IN THE

Supreme Court of the United States

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No. 824

DAVID BURNET,
COMMISSIONER OF INTERNAL REVENUE,
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VS.

HENRY HARMEL

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Brief of Walter E. Barton as Amicus Curiae in Opposition.

PRELIMINARY

W. T. Waggoner and Ella Waggoner filed appeals from the Commissioner of Internal Revenue to the United States Board of Tax Appeals, raising the question of whether cash considerations received by them in 1922 for the execution of certain instruments, commonly known as "oil and gas leases," on lands owned by them in Texas, which, under the law of Texas,

actually conveyed title to the oil and gas in place to the lessee, were taxable as capital gain within the purview of Section 206 of the Revenue Act of 1921. The Board of Tax Appeals held that such cash considerations were taxable as capital gain and not as ordinary income. (*W. T. Waggoner et al.*, 24 B. T. A. 657.) In deciding thus, the Board of Tax Appeals followed *Ferguson* v. *Commissioner*, 45 Fed. (2d) 573, and reversed its own previous decisions in *Ferguson* v. *Commissioner*, 20 B. T. A. 130, and *Harmel* v. *Commissioner*, 19 B. T. A. 376. Since the Board decided the *Waggoner* case, the Circuit Court of Appeals for the Fifth Circuit reversed the Board in the *Harmel* case, which judgment this Court is now requested by the petitioner herein to review. (R. 35.)

The same question that is raised in the instant case is presented in *W. T. Waggoner et al.* v. *Commissioner*, *supra*, and the decision of this court in the former will determine the issue in the latter.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Statement

The taxpayer is an individual residing at Megargel, Texas. In the year 1924 the taxpayer was, and had been for many years, the owner in fee simple of certain lands. In October, 1924, he executed two instruments, commonly known as "oil and gas leases," covering said land, on the basis of stipulated royalties and a cash consideration of $57,000.00. (R. 15.) This cash consideration was returned by taxpayer as gain from the sale of capital assets under Section 208, Revenue Act of 1924. The Commissioner of Internal Revenue

treated it as income taxable at the ordinary rates. (R. 9.) The Board of Tax Appeals held with the Commissioner (R. 18), and the Circuit Court of Appeals for the Fifth Circuit reversed the Board. (R. 35.)

The two oil leases referred to above are set out in full in the record. (R. 25-34.)

Question Presented

Whether a cash consideration received by the owner of lands situated in Texas, for the execution of an instrument commonly known as an "oil and gas lease," which, under the law of Texas, actually conveys title to the oil and gas in place to the lessee, is taxable as capital gain under Section 208 of the Revenue Act of 1924?

The findings of the Board of Tax Appeals were that the taxpayer received "stipulated royalties and a cash consideration of $57,000.00." (R. 15.) The opinion of the Board (R. 16) and the opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 35) refer to the $57,000.00 received as "cash consideration" and not as "advance royalties."

Statute Involved

The statute involved is Section 208 of the Revenue Act of 1924, which is printed in full in petitioner's petition beginning on page 2.

Reasons for Denying the Writ

1. Congress did not qualify the word "sale," and, hence, it was used in its ordinary sense. (*U. S.* v. *Merriam,* 263 U. S. 179.) If the instruments given by the taxpayer passed title to the oil and gas in place to the lessee, a sale was consummated, as this is the essence of a sale. (23 *R. C. L.* 1186; 55 *C. J.* 36.)

2. It is the settled law of the State of Texas that

such instruments convey title to the oil and gas in place to the lessee. (*Group No. 1 Oil Corp.* v. *Bass,* 283 U. S. 279; *Theisin* v. *Robison,* 117 Tex. 489, 502, 8 S. W. (2d) 646; *Texas Co.* v. *Daugherty,* 107 Tex. 226, 176 S. W. 717; *Stephens Co.* v. *Mid-Kansas Oil & Gas Co.,* 113 Tex. 160, 254 S. W. 290, cf. *W. T. Waggoner Est.* v. *Wichita Co.,* 273 U. S. 113.) Hence a sale was consummated by the taxpayer on the execution and delivery of the instruments in question.

3. The federal courts will follow state laws with respect to the title to property. (25 *C. J.* 839; 27 *R. C. L.* 51; 28 *U. S. C. A.,* annotation 143; *Guffey* v. *Smith,* 237 U. S. 112, 115; *Poe* v. *Seaborn,* 282 U. S. 101; *U. S.* v. *Robbins,* 269 U. S. 315; *U. S.* v. *Malcolm,* 282 U. S. 792; *Crooks* v. *Harrelson,* 282 U. S. 55; *U. S.* v. *Cambridge Loan & Bldg. Co.,* 278 U. S. 55.)

In *Group No. 1 Oil Corp.* v. *Bass,* 283 U. S. 279, this Court held that under the decisions of the highest court of Texas, instruments, such as the ones involved in the instant case, conveyed title to the oil and gas in place to the lessee, and that such decisions were binding upon Federal Courts as a rule of local law defining property rights. This was the contention of the government in that case (Government's brief, p. 5); but now this Court is asked to disregard the law of Texas regarding vested property rights.

4. A number of cases are cited by petitioner to support his position, but in our opinion they do not do so.

In *Work* v. *Mosier,* 261 U. S. 352, the question was whether under the Act of Congress of June 28, 1906, cash bonuses received on the execution of oil and gas leases of Osage Indian lands should be classed as capital or income. If capital, the bonuses were to be held by the Secretary of the Interior; and if income, they were to be paid over to the Indians. This Court held

that the question of whether bonuses were to be included in royalties was a matter of statutory construction, and that in view of the entire statute involved, bonuses were more aptly described as income than as capital. Not only were the lands situated in Oklahoma, where the law of the state is that oil and gas leases do not convey title to oil and gas in place to the lessee (*Rich* v. *Doneghey,* 71 Okla. 204, 177 Pac. 86); but the Act of June 28, 1906, specifically provided that title to the oil and gas in place should not vest in the Indians for twenty-five years, and that the oil and gas in place could not be sold.

In *Strattons' Independence* v. *Howbert,* 231 U. S. 399, this Court held that mining corporations extracting ores from their own premises were subject to the Excise Tax Act of 1909; that the proceeds from the sale of such ores were income; and that the difference between the selling price of the ores and the cost of removing the same was not deductible as *depreciation* under said Act. In *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, it was held that royalties received by a corporation lessor of Minnesota lands represented income under the Excise Tax Act of 1909 and not the conversion of investment from ore into money, following *Strattons' Independence* v. *Howbert, supra,* and that the taxpayer was not permitted to deduct the value of the extracted ore in place as *depreciation.* In *U. S.* v. *Biwabik Mining Co.,* 247 U. S. 116, it was held that the proceeds of iron ore mined by a corporate lessee of Minnesota lands were income under the Excise Tax Act of 1909, and that the taxpayer could not deduct as capital invested the fair market value of the ore in place as of January 1, 1909. It was held that under Minnesota law a lessee was not a purchaser of the ore in place, and that the Court had pointed out this fact in *Von Baumbach* v. *Sargent Land Co., supra.* In

Stanton v. *Baltic Mining Co.*, 240 U. S. 103, 114, this Court rejected the taxpayer's contention that the Revenue Act of 1913 was unconstitutional as an unapportioned direct tax when applied to mining corporations because the 5 per cent allowance for depletion was inadequate. It was not held by the Court below in the instant case that the cash considerations did not represent income, but merely that the *source* of the cash considerations was from the sale of the oil and gas in place.

The decision below is not in conflict with *Burkett* v. *Commissioner*, 31 Fed. (2d) 667; *Berg* v. *Commissioner*, 33 Fed. (2d) 641; *Murphy* v. *Commissioner*, 9 B. T. A. 610; *Reynolds* v. *Commissioner*, 10 B. T. A. 651; all of which involved oil and gas leases of lands situated in Arkansas, nor with *Alexander* v. *King*, 46 Fed. (2d) 235, which involved an oil and gas lease in Oklahoma, where the law of the respective states is that such an instrument does not pass title to the oil and gas in place to the lessee. (*Osborn* v. *Arkansas Ter. Oil & Gas Co.*, 103 Ark. 175; *Rich* v. *Doneghey*, 71 Okla. 204, 177 Pac. 86, 89.) In deciding *Alexander* v. *King*, *supra*, the Circuit Court of Appeals for the Eighth Circuit not only held that it was necessary to look to the Oklahoma law to see whether title to the oil and gas had passed to the lessee, but clearly distinguished its decision from *Ferguson* v. *Commissioner*, *supra*, by pointing out the difference between the laws of Texas and Oklahoma on this question.

The statutes involved in the cases of *U. S.* v. *Cambridge Loan & Bldg. Co.*, 278 U. S. 55, and *Crooks* v. *Harrelson*, 282 U. S. 55, did not indicate that Congress intended that local state laws should govern the classification. The terms used were general, and this Court held that the respective state laws were determinative of the questions. In *Burk Waggoner Oil Assn.* v. *Hop-*

kins, 269 U. S. 110, this Court held that the term "association" as used in the Act comprehended partnerships similar to the one involved in that case, and that the local law of the state was without legal significance as bearing upon the *power* of Congress to determine how and at what rate the income of a joint enterprise should be taxed. In the instant case the term "sale" is not defined in the Act, and the only question presented is one of construction and not one of power. In *Weiss* v. *Weiner,* 279 U. S. 333, the question was whether a lessee of a long term lease acquired after March 1, 1913, could take a deduction for depreciation of buildings, where he did not pay anything for the lease except an annual rental and did not pay for the buildings on the leased premises. This Court held that he could not, and that it was immaterial that under the Ohio law, where the properties were located, such a lease was treated in many respects as a conveyance of the fee. There was no capital invested, and, hence, no allowable deduction.

In *Rosenberger* v. *McCaughn,* 25 Fed. (2d) 699, the lessor of Pennsylvania lands gave a lease long prior to March 1, 1913, reserving monthly rentals. The Court recognized that under the Pennsylvania law the lease conveyed title to the coal in place to the lessee, and held that a part of the payment represented capital and a part income, but inasmuch as the taxpayer merely contended that the *entire* payments were capital and not income, the findings of the Commissioner of Internal Revenue were not disturbed. In *Pocahontas Coal Co.* v. *Commissioner,* 55 Fed. (2d) 626, coal leases of West Virginia lands made prior to March 1,1913, were involved. The Court recognized that under the West Virginia law such leases conveyed title to the coal in place to the lessee, but rejected the taxpayer's contention that the *entire* royalties received from 1920 to 1926

represented capital. No alternative contention was made that the present worth of the royalties on March 1, 1913, represented capital, but merely that the depletion allowance was inadequate. These cases would be applicable to the instant case if the taxpayer had made the leases in question prior to March 1, 1913, with cash consideration deferred until 1924, and then contended that the entire cash consideration was capital in the year in which received.

5. The only case cited by petitioner, which in our opinion is in conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in the instant case, is *Hirschi* v. *U. S.*, 67 Ct. Cl. 637. The Court of Claims held that Texas law did not govern in determining whether a sale of the oil and gas in place had been made, citing *Steedman* v. *U. S.*, 63 Ct. Cl. 226. The latter case involved the identical question as *Crooks* v. *Harrelson, supra,* and was overruled by this Court in the latter case. Furthermore, since the *Hirschi* case was decided, this Court, in *Group No. 1 Oil Corp.* v. *Bass,* 283 U. S. 279, sustained the Circuit Court of Appeals for the Fifth Circuit (41 Fed. (2d) 483), and held that under the law of Texas an instrument similar to the ones involved herein conveyed title to the oil and gas in place to the lessee, and that the law of that state was controlling as to the *source* of the income of the lessee. That decision necessarily settled the rule that the granting of an instrument, customarily known as an "oil and gas lease," in Texas constitutes a sale of the oil and gas in place to the lessee, and that the Texas law is binding upon Federal Courts in connection with Federal income tax questions. (*Guffey* v. *Smith,* 237 U. S. 101.)

CONCLUSION

The decision of the Circuit Court of Appeals for the Fifth Circuit was correct and the case does not present

questions justifying the consideration of this Court on writ of certiorari.

Respectfully submitted,

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